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ADDRESS

ON THE

BANKING SYSTEM OF CANADA

AND ON THE

RESUMPTION OF SPECIE PAYMENTS

IN THE UNITED STATES,

Delivered before the New York Convention of the

American Bankers' Association,

BY

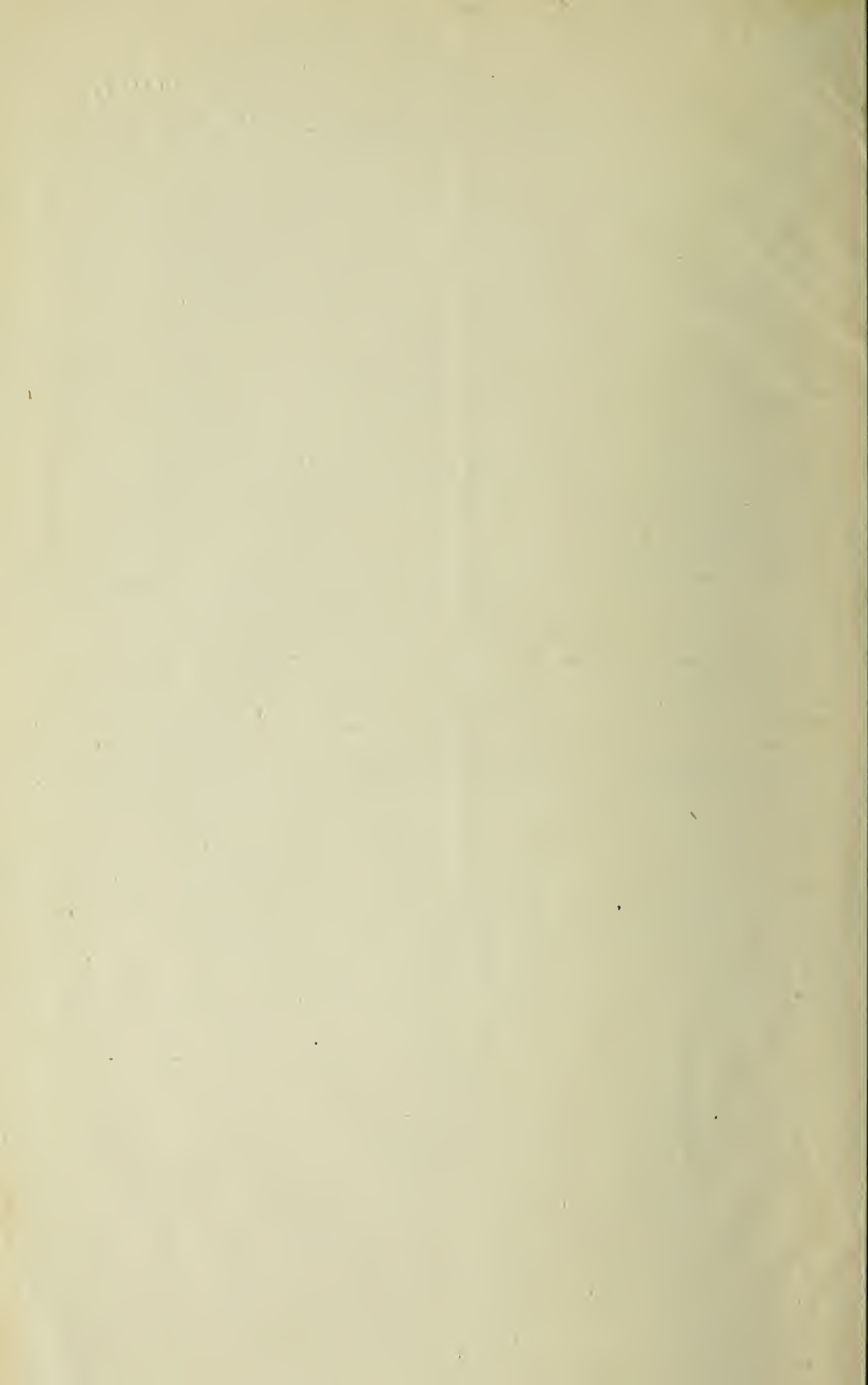
Sir FRANCIS HINCKS, K. C. M. G.,

*President of the Consolidated Bank of Canada and late Finance
Minister of the Dominion.*

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ADDRESS OF SIR FRANCIS HINCKS.

Mr. President and Gentlemen :

When I left Montreal a few days ago on a short tour, I had no idea that I should have an opportunity of attending your Convention, and of taking part in the discussion of questions in which for upwards of forty years I have taken a deep interest, and to the study of which I have devoted much time and thought. Permit me to thank you most sincerely for your courteous invitation, and to assure you that I highly appreciate it. In accordance with the suggestion of your Secretary that I should preface the few observations that, with your permission, I shall make on the subject immediately under discussion, with some account of our Canadian monetary institutions, I shall endeavor as far as possible, within the limits to which I am necessarily confined, to touch on those points which seem to me worthy of notice. Our Canadian banking system was modelled on that which formerly prevailed very generally in the United States. Banks were chartered by the Legislature, with paid up capitals, and authority to issue notes redeemable in specie on demand. The charters contained what was known as the double liability clause, each shareholder being liable to the creditors of the chartered Banks to an amount equal to his paid up stock. There was a small tax on bank issues and the banks were required to hold ten per cent. of their capital in Government securities. A short time prior to the Confederation of the British Provinces into the Dominion of Canada in 1867 an attempt was made by the Government to substitute a Government paper currency for that of the Banks, and inducements were held out to the Chartered Banks to surrender their right of issue, and to use the Government notes, which were legal tenders. The Bank of Montreal alone accepted the terms proposed by the Government. In the year 1869 the Bank charters expired, and a renewed attempt was made to compel the Banks to base their issues on Government securities, very much on the plan under which the National Bank issues of the United States are regulated. When the Government proposition was submitted to Parliament it was found that the opposition to it, especially from the Province of Ontario, was so strong that it would be impossible to carry the bill, which was therefore withdrawn for the time, and the charters were all renewed for a year. It was during the recess of Parliament in 1869 that I returned to Canada after an absence of about fourteen years in the West Indies in the service of the Crown. The Minister of Finance, Sir John Rose, had only a few weeks previously intimated his intention of withdrawing from public life, and leaving Canada to reside permanently in London. Other vacancies in the Government occurred about the same time, and a few weeks after my return to Canada, I was invited to join the Government. When I consented to do so, I was in hopes that the Finance Department would be filled by a gentleman well qualified to deal with the banking question, the settlement of which could not be postponed. When, however, the arrangements were completed, I became Minister of Finance, an office which I had previously filled during a period of seven years, terminating about fifteen years before the time of my resuming it. I gave immediate attention to the Bank question, and after conferring frankly with the representatives of the principal banks, I was able to mature measures which, having been sanctioned by the First Minister and my other colleagues in the Government, were approved of by Parliament and became law. The Dominion note system is so connected with the Banking Act, which is a general measure applicable to all the Chartered Banks, that it will be convenient to notice them together. Prior to 1869 the Government had full authority to issue notes of all denominations, but it had no means of circulating them, other than under the then subsisting arrangement with the Bank of Montreal, which it was desirable to terminate, as the other banks were unwilling to concur in it. I pro-

posed to the Banks that they should consent to give up their issues of small notes under \$4, which should in future consist exclusively of Dominion notes. I further proposed that instead of holding their reserves exclusively in gold, they should hold one-half, or never less than one-third, in Dominion notes, it being understood that the Government would not issue the denominations between \$50 and \$4. The Government on its part agreed to abandon the tax on bank issues, and also the requirement that the banks should hold government securities to the extent of one-tenth of their capital. I may observe here that the tax on bank notes was the only one imposed upon the banks by the Dominion Parliament, which never entertained for a moment the idea of taxing bank deposits or bank capital, nor, indeed, am I aware that such taxes are imposed in any other country but the United States. It must be borne in mind that the Canadian banks are not required to hold any special percentage of their circulation and deposits as a reserve. Statements are made monthly to the Government, and published without delay, but the amount of reserve is left to the discretion of each bank. The Dominion legal tenders are redeemable in gold by Assistant Receiver General, at Montreal, Toronto, Halifax and St. John, N. B. It may be supposed that such an arrangement would be found inconvenient, as the Toronto notes are a legal tender at Montreal, Halifax and St. John, though only redeemable in Toronto. In practice no inconvenience has been felt, and though I think a single office of redemption has much in its favor, there seems no probability of the present arrangement being disturbed. The Dominion \$1 and \$2 notes are circulated to the extent of about three millions of dollars, but the larger notes are kept by the banks exclusively as reserves. The aggregate circulation of Dominion notes is about \$11,200,000. \$7,200,000 are based on Government securities, and for all the issues exceeding that amount, the Government is required to hold either gold or bank deposit receipts, the latter being only permitted when the gold is in excess of the percentage required by law, which varies from 25 per cent. upwards, increasing as the circulation increases. There is not the slightest tendency to inflation in the Government circulation. The banks naturally issue their own fives and fours in preference to the Dominion small notes which only circulate to the extent of the public demand. The large notes are not kept in excess of the requirements of the banks. The chief point of difference in our system from yours, is that the banks are allowed to circulate notes to the extent of their paid up capital, at their discretion, and you will observe that the assets held against that liability, in excess of the reserve, consist of "bills discounted." The National Bank assets, held against their bank note liability, consist of Government bonds deposited with the treasury. This will explain the objection entertained both by the banks and the public, to the various propositions made from time to time to substitute Government securities for commercial paper. Another important difference in our system from yours is that nearly all our banks have a large number of branches and agencies, while your practice is to have no agencies. I note this difference in our system from yours, without attempting to discuss the merits of the two systems. The agency system necessitates vigilant inspection, and certainly has its weak points, though it has likewise its advantages. A considerable business is done by advances on warehouse receipts for produce purchased in the vicinity of the agencies and delivered at our commercial capital—Montreal. Our banks deal largely in foreign exchange, and have nearly all London correspondents, while two or three have offices of their own in London and New York. With regard to the relations between the Government and the banks, I may mention that the bank of Montreal has been for many years the fiscal agent of the Government, receiving the revenue at all the principal ports of entry, and paying the Government cheques wherever required. The Government of Canada having charge of the construction of public works, has been a borrower in London, and consequently a drawer of exchange. Its exchange is offered to public competition, and the proceeds are occasionally left with the purchasing banks, or placed in special deposit at interest. The Government is also a constant purchaser of exchange to meet the interest on its debt, and this it likewise purchases by tender from the banks. We have not yet introduced the system of clearing house settlements in Canada. There are no special safeguards of solvency, and notwithstanding constant complaint of the ruinous management of estates by assignees, it strikes me that compositions with insolvents are more rare with us than in England. Our savings bank law was originally modelled on yours, but was repealed a few years ago. We have an admirable Post

Office Savings Bank system, which is being gradually extended. Several of the chartered banks have Savings Bank departments, and there are three other savings banks, one at Montreal, one at Quebec and one at Toronto, which were, at the time of the repeal of the old act, specially chartered. It was deemed expedient by our Government and Legislature that institutions receiving deposits from the poorer classes of society should give the same security as those receiving the deposits of the wealthier classes, and when the old savings bank act expired, about six years ago, it was not renewed, and the few existing institutions were given the option either to amalgamate with a chartered bank or to organize with a large subscribed capital, twenty-five per cent. of which should be paid up, or to wind up. Of the five institutions then existing two wound up, paying their depositors in full, two organized with a proprietary—one with a capital of two millions, the other with one million, and one obtained a special temporary act to continue on its old footing. The Canadian municipalities have a considerable indebtedness, chiefly owing to the numerous bonuses given to railways. They are required to submit all by-laws for creating these obligations for the approval of the tax-payers by special vote, and there are stringent provisions in the municipal act for enforcing payment of such obligations by means of rates leviable by the sheriffs. I fear that I have occupied too much time with these preliminary observations, which I have made in accordance with a suggestion to that effect. The immediate subject for present discussion is the resumption of specie payments, and I can assure you that it is one in which your Canadian neighbors feel a very deep interest. I have long observed, with regret, that the advocates of an inconvertible paper currency are both numerous and active, while on the other hand the advocates of resumption seem to be quite disunited. I am not an inattentive observer of what is going on among you, but I confess that I am wholly unable to discover how the opponents of resumption expect to realize the advantages which it is their object to attain. They profess to apprehend that the consequence of resumption would be a contraction of the currency, the effect of which would be to limit the loaning power of the banks. Now, I apprehend that the loaning power of the National Banks is limited precisely as it is with us—by the amount of their capital, deposits and circulation. It is the interest of banks to loan as much as they can do with safety. If the National Banks were enabled to issue inconvertible notes very much at their discretion, as the old chartered banks were during the suspension of 1837, there would, of course, be an increase to their loaning power; but under the present system, the National Banks cannot increase their circulation, and it really is unimportant to them whether they are bound to redeem their liabilities in convertible or inconvertible legal tenders. I believe that the tendency of resumption would be to increase the loaning power of the National Banks. I assume that it is found profitable to issue national bank notes on the present basis, otherwise they would not be issued. Now, I believe that the tendency of resumption would be to cause a considerable substitution of National Bank notes for legal tenders. Under the present system there cannot be a redundant issue of National Bank notes, and on the assumption that there is a redundant issue of legal tenders, such issue does not increase the loaning power of the banks, and as no commercial paper is held against it, its increase or diminution would only be felt in an increase or reduction of the premium on gold, which is, and must continue to be, notwithstanding any legislation in a contrary direction, the real measure of value. The legal tender circulation is at present about three hundred and fifty millions. If it were reduced, by any means, to three hundred millions, gold would probably be at par. If it were increased by fifty millions, there would be a considerable increase in the premium on gold. If a bi-metallic standard were adopted, gold would be at a higher premium than it is at present, but would not cease to be the real standard. Among the advocates for resumption there are some who desire to withdraw the legal tenders entirely from circulation. It seems probable that this proposition is supported in the interest of the National Banks. My own conviction is that under such a system as we have in Canada, the National Banks as well as the people at large would materially benefit by the retention of legal tender circulation. The chief object of maintaining that circulation is to economize the use of gold or silver, if the latter standard should be adopted. If the legal tenders were withdrawn every bank in the United States would have to keep its reserves in coin to meet its liabilities on demand, although in practice the City of New York is the national clearing centre of the

United States, as London is for the United Kingdom. The cost to the nation of maintaining these coin reserves would be enormous, but the inconvenience would be felt even more, and this would be intensified if it should be necessary to move silver instead of gold. I believe that if all rivalry between the government and the National Banks could be removed, the convenience to the latter of the legal tender notes would induce them to withdraw all opposition to their issue. That it is possible to avoid rivalry our Canadian experience places beyond a doubt. Were it not for the small note issue for the surrender of which our banks got an equivalent in the abolition of the bank tax, a Government note would never be seen by the general public in Canada. The notes from \$50 to \$1,000 are held by the banks as reserves, and constitute a much more convenient instrument than coin for settling balances. I think that in the United States it would be desirable that a mutual understanding should be arrived at between the Treasury and the banks to the effect that the former would issue no notes between either \$100 or \$50, and a small denomination under \$5. The National Banks should be satisfied, I think, with the circulation of notes of \$5 and upwards. The practical effect would be that the Government note circulation would be limited to the requirements of the banks for reserves, and the notes under \$5. I believe that the effect of such a plan as I have indicated would be to increase the National Bank circulation and thereby the loaning power of the banks, and to give the nation a bank note currency superior to that in any country in the world.

I am aware that during the last two years there has been a reduction in the National Bank Capital, and this would lead to the inference that new capital would not be subscribed even if it were to lead to an extended circulation. I do not think such an inference would be correct. The reduction of capital I attribute to the policy of the government which is driving capital out of banking by excessive taxation. If national bank notes were obtainable on a deposit of 4 per cent. bonds, I believe that they would be applied for, and take the place of legal tenders to a considerable extent. I have not adverted to the mode of effecting or preparing for resumption, and I labor under the disadvantage of being unaware of the impediments in the way of a gradual substitution of United States interest-bearing bonds for any redundant issues. The price of gold would lead to the inference that the legal tender issues are not much, if at all, in excess of the public requirements. Monthly sales of United States 4 per cent. bonds for legal tender would soon bring them to par, and if my opinion should prove correct that after resumption, National Bank notes would take the place of legal tenders to a considerable extent, the practical effect would be that United States bonds would be deposited for such increased national issues, and would replace the present legal tenders. If it were ascertained, as it soon would be under a convertible system, what amount of legal tenders would be required for public convenience, there would be no difficulty in maintaining an adequate reserve of coin at the office of redemption, which should certainly be in New York and not in Washington. I may here observe, that in times of panic which, it may be feared, will occur from time to time in all countries where extensive credits are given, there would be less danger of large demands for gold in redemption of legal tender notes in the United States, than in England. In the United States, and in Canada likewise, each bank keeps an adequate reserve to meet its liabilities, and would, for its own sake, endeavor to keep that reserve as strong as possible. In England, it is admitted by all the best writers on the subject, that the banks generally rely on the Bank of England to carry the commercial classes through a panic. That bank is the custodian of the national reserve, and any one who examines the bank's statements a week or two before the Overend, Gurney & Co. failure in 1866 and those a fortnight later, will at once perceive what a load that bank is obliged to carry at a period of financial embarrassment. In America the burden would fall on the banks generally, and would certainly not be so embarrassing. I have, I fear, trespassed too long on your attention, and have to offer my apologies for the defects of this paper, which I have had to prepare quite unexpectedly, and without having had any opportunity to consult authorities. I must, therefore, throw myself on your indulgence and have to thank you for the opportunity of being present on such an interesting occasion.





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